26 U.S.C. § 7122
estoppel

In re Price Case No. 387-34705-P11
Price v. IRS Adv. # 91-3060

6/18/92 Judge Perris unpublished

The court found that a settlement agreement between the debtor and the attorney for the I.R.S. included postpetition interest on prepetition taxes. However, the authority to settle tax disputes is delegated only to certain individuals, and the attorney for the I.R.S. did not have actual authority to settle the issue of postpetition interest. Nevertheless, the government was estopped from collecting the postpetition interest. All the traditional elements of estoppel were present. Additionally, to estop the government there must be affirmative misconduct and a serious injustice outweighing the damage to the public interest of estopping the government. The I.R.S. attorney's conduct in leading the debtor to believe that the attorney possessed the requisite authority met the special criteria needed to estop the government.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re:	)	Case No. 387-04705-P11
	)	
JENNIFER PRICE, aka JENNIFER PRICE-MCGINNIS	)	
	)	
Debtor.	)	
	)	
JENNIFER PRICE,	)	Adversary No. 91-3060
	)	
Plaintiff,	)	
	)	
v.	)	MEMORANDUM OPINION
	)	
UNITED STATES OF AMERICA, by and through THE DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE	)	
Defendant.	)	

The sole remaining issue in this adversary proceeding is whether the debtor, Jennifer Price, is liable for postpetition interest upon certain nondischargeable prepetition taxes. As this matter concerns the determination of the amount of the

debtor's tax liability, it is a core proceeding over which I have jurisdiction under 28 U.S.C §§ 1334, 157(b)(2)(I), (K) and (O) and 11 U.S.C. § 505.

The debtor contends that the Internal Revenue Service ("I.R.S."), through its attorney and agent Jeffrey Wong, entered into an enforceable agreement to waive the postpetition interest, or, in the alternative, that it is estopped from asserting that the debtor remains obligated for the interest. The I.R.S. contends that the agreement it entered into concerned only prepetition claims, and that its agent did not have the authority to bind the government to any other agreement. The I.R.S. also contends that estoppel will not lie against the government in this case.

BACKGROUND

The debtor is married to Lew McGinnis, who had a separate chapter 11 case pending before this court. The debtor's and McGinnis's business affairs were convoluted, involving more than eight different entities controlled by the debtors. Sorting out the various entities and the tax obligations owed by each was a difficult matter, and the I.R.S considered a substantial portion of the tax obligations as jointly and severally owed by both McGinnis and the debtor (collectively "debtors.")

I.R.S. filed proofs of claims in both cases, taking the position that various entities were the debtors' alter egos and

the debtors were therefore liable for all unpaid taxes owed by each of the entities. In addition, the I.R.S. contended that the debtors were "responsible parties" for various entities, and were therefore liable for unpaid withholding tax. The I.R.S. contended that a substantial portion of the taxes were secured. The debtors disagreed with the I.R.S. position.

ISSUES

1. Whether the settlement agreement between the debtor and the I.R.S. included the issue of postpetition interest on prepetition taxes.

2. If the agreement included postpetition interest, did the I.R.S. attorney have authority to bind the I.R.S. to the terms of the settlement.

3. If the I.R.S. attorney lacked authority to settle the issue, is the I.R.S. nevertheless estopped from claiming postpetition interest on prepetition taxes.

DISCUSSION

A. The Settlement Agreement

Resolution of the disputes concerning the I.R.S. claims was integral to the debtors' reorganizations. On June 8, 1990 the debtors and their counsel, Victor VanKoten, met with Jeffrey Wong, an attorney for the I.R.S. Also present was an I.R.S. agent, Mike Fargo. The subject, as Mr. VanKoten explained, was

> a whole mass of stuff that was just bristling with tax issues that we were trying to contain and sever

> and settle. And - - and this postpetition interest, of course, was one of the things that we wanted to settle. It was only one of them, though.

Tr. at 63.

Mr. Wong claims that he did not believe that postpetition interest was one of the subjects of the settlement discussions. However, at the outset of the meeting, the debtors very clearly expressed their understanding that the purpose of the meeting was to discuss an omnibus settlement of all outstanding tax liabilities. Mr. McGinnis initially spoke on behalf of himself and Ms. Price, explaining that he wanted to fully resolve all outstanding tax matters. He emphasized that after confirmation, neither he nor Price wanted the I.R.S. contending that any taxes remained which were not dealt with by the plans.

Mr. Wong, who was conducting the negotiations on behalf of the I.R.S., was aware of the debtor's and McGinnis's understanding regarding the scope of the settlement discussions, and said nothing to indicate any disagreement with the parameters outlined by Mr. McGinnis. To an objective observer, everyone in the room agreed with that agenda. At no point in the course of negotiations did Mr. Wong disabuse the debtors or their counsel of the impression that postpetition interest on prepetition claims was one of the issues which would be resolved by the negotiations.

The parties met again on June 22, 1990. They discussed

the allocation of the total tax obligations between the two debtors for administrative convenience and agreed on the amount of the claim to be treated as secured (which would permit the I.R.S. to claim postpetition interest on the secured portion under § 506(b)) and the amount which would be unsecured. There was no discussion of excluding from the settlement postpetition interest on the unsecured claim.[1]

In fact, a suggestion made by Mr. Wong in structuring the settlement indicates his intent that the debtor would not be liable for postpetition interest except to the extent that claims were treated as secured. During the settlement discussion, Mr. Wong's charitably suggested that the debtors could save money by allocating certain of the tax obligations to McGinnis's case, which was filed before the Price case.

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[1] Mr. Wong did not recall any specific discussions in which he advised the debtors that he did not intend to settle postpetition interest. Wong depo. at 87. Mr. Werstler, an I.R.S. representative present at the June 22, 1990 meeting, testified that at the meeting he made it clear that postpetition interest would not be part of the settlement, but his recollection is suspect. He kept no notes of the meeting. He admitted that he had discussed the issue in "multiple conversations" with Mr. VanKoten, but did not recall any such discussions regarding "this ... particular taxpayer." Tr. at 18, lines 11 to 14. In light of the other evidence that supports the debtor's position, I believe it is likely that Mr. Werstler confused the meeting in question with some other discussion he had with Mr. VanKoten. I therefore conclude that Mr. Werstler did not state that postpetition interest would not fall within the scope of the settlement discussions with this particular debtor.

> Q- Did you attempt to structure these transactions so that you would get the benefit of the interest differential that [the debtor] might otherwise pay if the accounts were handled differently?
>
> A- [by Mr. Wong] - I think -- it wasn't Ms. Price specifically, but I think Mr. VanKoten probably characterized it pretty accurately as a bone to the taxpayers in resolution of these proceedings. I was in fact amendable to setting up the liabilities in the manner that would be most beneficial to [Mr. McGinnis and the debtor].
> ...
> Q- What was the benefit?
> A- Ms. Price's -- Ms. Price's case was filed -- I don't know -- nine months or a year after Mr. McGinnis' case was filed. The pre-petition -- a lot of the liabilities at issue in this case had actually been accrued prior to the filing of either of the cases, and of course, pre-petition interest accrues and is collectable through the bankruptcy case up until the date of the petition.
> So if we had put the liabilities into Mrs. Price's case rather than into Mr. McGinnis' case, would -- the plan would have had to have provided for an additional nine months' accrual of interest on the pre-petition liabilities, whereas <u>if we put them into Mr. McGinnis' case, since his case was filed earlier, there's a shorter period of time for the accrual of prepetition interest. So as a consequence, through the plan of reorganization they have to pay less.</u> (emphasis added)

Tr. at 146 to 148 .

That explanation indicates that Mr. Wong intended interest to cease upon the filing of the petitions (except for those claims treated as secured). If, as the I.R.S. now contends, the debtor remains liable for postpetition interest on prepetition taxes, the "bone" offered by Mr. Wong was illusory, as there is no suggestion that it made any difference to the debtor whether a tax debt was paid through the plan or independent of the plan.

The only taxes excluded from the settlement by Mr. Wong were new taxes which first became due during the administration period. As to those taxes, Mr. Wong stated that he lacked authority to compromise. As to the rest of the subjects covered by the parties, Mr. Wong stated that they "had a deal." Tr. at 39, 40.

At no point did Mr. Wong indicate that he did not have the authority to bind his client to the settlement reached by the parties, although he explained that he could not stipulate to an order regarding the treatment of the I.R.S. claim. Instead, he recommended a procedure whereby the debtor and McGinnis would withdraw their objections to the I.R.S. claims, and the I.R.S. would submit amended proofs of claims which conformed to the parties agreement. The I.R.S. would then be paid through the debtor's and McGinnis's plans of reorganization.

Mr. Wong prepared the settlement documentation. In a July 10, 1990 letter to the debtor and McGinnis (Plaintiff's ex. 1), Mr. Wong stated his calculations of the amount due under the settlement agreement, which he expressly stated was "inclusive of pre-confirmation interest." Mr. Wong's attempt to dismiss that statement as a simple mistake is unconvincing.

Another document prepared by Mr. Wong which corroborates the debtor's version of the settlement is a Consent to Assessment form (Exhibit F to Plaintiff's Motion for Summary Judgment).

That form stated that McGinnis would be obligated for postpetition interest only to the extent provided in the Chapter 11 plan. Mr. Wong signed an endorsement on that form in which he acknowledged and agreed to those conditions on behalf of his client. Mr. Wong explained that he did not prepare a similar document for the debtor because, due to the nature of the taxes allocated to the debtor, a similar form was not needed. Nevertheless, it was clear that the scope of the McGinnis settlement and the debtor's settlement were the same[2], and the debtor would therefore be liable for postpetition interest to the extent provided in her plan.

On September 12, 1990 Mr. VanKoten sent a letter to Mr. Wong (exhibit I) which further corroborates the debtor's understanding that postpetition interest was part of the settlement. The letter, which enclosed a check for $133,959.22 for the debtor's portion of the settlement payment, stated the following:

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[2] With the exception of allocating different taxes between the debtor and McGinnis to provide the debtors with a benefit regarding the accrual of postpetition interest, the I.R.S. treated the settlement of claims against the debtor's and McGinnis's as one in the same. Mr. Wong could not recall any discussions of treating the debtor and McGinnis differently. Wong depo. at 88. The I.R.S considered a substantial portion of the tax obligations as jointly and severally owed by both McGinnis and the debtor, and took the position that the various entities were the alter egos of both debtors. Mr. Wong stated that he did not care whether the payment came from Mr. McGinnis or the debtor. R. at 140. There was no mention that the scope of Mr. McGinnis's settlement would be broader than the scope of the debtor's. R. at 174, 180, 181.

> It is our understanding that if there was any post-petition interest, it has been waived and this payment is payment in full of the I.R.S. claim in the Price Chapter 11 case.
>
> . . . .
>
> If for any reason any of the above does not accurately state our agreement, you are not authorized to negotiate the enclosed check and are instructed to instead immediately return the same to this office. (emphasis added).

The I.R.S. cashed the check, and did not indicate any disagreement regarding the issue of postpetition interest. The I.R.S attempts to minimize the significance of the letter by claiming that it was sent after the settlement discussions had been concluded. However, the letter, and the I.R.S. failure to contest the statements therein, are competent evidence of the confirmation of the parties' earlier agreement.

Further evidence of the parties' intent regarding postpetition interest is their treatment of certain liens on property of the debtor. The debtor borrowed the money to pay off the settlement amount from a business acquaintance, Michael Mastro. Mr. Mastro held a lien upon the property encumbered by the I.R.S. liens, and was therefore anxious to have the lien removed. However, because the liens asserted against the debtor were being paid under the McGinnis plan of reorganization, it was agreed that the tax liens on the debtor's property would be released upon payment by McGinnis. Because the McGinnis payment was late, the I.R.S. contended that additional sums were due from McGinnis, and initially was unwilling to deliver lien releases.

Mastro refused to pay any additional amounts, and would not make any payment on behalf of McGinnis without first obtaining the lien releases. Mr. Wong's client finally relented and instructed Mr. Wong to surrender the lien releases in exchange for the payment Mastro was willing to make.

Only a few days after the McGinnis payment was made, the I.R.S. gave the debtor notice of its intent to levy upon her property again, this time for the postpetition interest. The debtor's attorney was understandably upset. There would have been no point to negotiating lien releases if the I.R.S. could contend that there were still outstanding sums which provided a basis for a new lien on the same property. The debtor's attorney called Mr. Wong to protest. Mr. Wong, however, could not immediately provide an explanation for the I.R.S.'s actions. If, in fact, he believed (as he now claims) that the settlement agreement did not encompass the postpetition interest, it is reasonable to expect that he would have immediately volunteered that explanation.

The above evidence persuades me that Mr. Wong and his client understood and agreed that postpetition interest on prepetition taxes was one of the liabilities which would be extinguished by the parties' settlement except to the extent provided in the plans of reorganization. See Eldon D. Anthony v. United States of America, No. 90-C-1416 (D. Colo. May 29, 1991)

(because interest is "part and parcel of the tax due under the Internal Revenue Code," an agreement to settle taxes, unless otherwise stated, also settles the interest on those taxes).

B. Mr. Wong's Authority to Bind the I.R.S.

The I.R.S. contends that, even if I find that the agreement encompassed postpetition interest on prepetition taxes, it is unenforceable because Mr. Wong did not have any settlement authority. I agree that he did not possess the requisite authority. 26 U.S.C § 7122 provides:

> the Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

Either the matter had not been referred to the Department of Justice, or Mr. Wong was not delegated settlement authority under the so-called "Houston Plan." The "Houston Plan" is an internal I.R.S. procedure which concerns delegation of settlement authority. The "Houston Plan" is not published in a form generally available to the public. Tr. at 176, 177.

The courts have insisted that a settlement of tax disputes will not bind the I.R.S. unless the appropriate official is a party to the agreement. It is not sufficient that one of the official's subordinates is a party to the agreement to waive taxes. Botany Mills v. United States, 278 U.S. 282, 288 (1928).

Mr. Wong did not possess the inherent authority by virtue of his office. See United States v. McCue, 178 F.Supp. 426, 433 (D. Conn. 1950) (quoting United States v. Beebe, 180 U.S. 343, 351.)

C. Estoppel

If the I.R.S. is allowed to prevail, it gained a real advantage in the negotiations through Mr. Wong's lack of authority. Mr. Wong could make any representations to the debtor without having to worry about delivering on the promises because he lacked authority to bind the I.R.S. to anything. Mr. Wong apparently was aware that the dialogue was essentially one-sided, with the I.R.S. dictating the terms. That fact is evidenced by Mr. Wong's approach to the negotiations:

> Q- But I'm asking you to explain ... how you could have possibly been thinking ... that you were going to have a rather small circle here that we were settling within when you acknowledge that you recall Mr. McGinnis saying that he and [Ms. Price] came in and they desired to resolve all of their tax disputes with the I.R.S.?
>
> . . . .
>
> A- (By Mr. Wong) . . . . Now as far as what Mr. McGinnis said his druthers were or were not really didn't matter to me. And I don't even think I responded at all to what Mr. McGinnis said. He opened the conversation up with that type of a statement and I let him say it.

Tr. at 153, 154.

I agree with the debtor that, by virtue of Mr. Wong's conduct, the I.R.S. is now estopped from claiming postpetition interest on the prepetition taxes. The conduct of a government

agent or official may provide the basis for estoppel even if that agent has acted outside his or her authority. See Brant v. Hickel, 427 F.2d 53, 56 (9th Cir. 1970); Tonkology v. United States, 417 F.Supp. 78, 79 (S.D. N.Y. 1976). The elements of estoppel are: (1) knowledge of the true facts by the party to be estopped; (2) intent to induce reliance; (3) ignorance of the true facts by the relying party; and (4) detrimental reliance. Bolt v. U.S., 944 F.2d 603, 609 (9th Cir. 1991). Additionally, for the government to be estopped there must be affirmative misconduct and a serious injustice outweighing the damage to the public interest of estopping the government. Id. Affirmative misconduct requires "an affirmative misrepresentation or affirmative concealment of a material fact by the government." Id.

All the above elements are present. Mr. Wong misrepresented to the debtors that they "had a deal" with the I.R.S. That misrepresentation included his concealing the fact that he lacked the authority to conclude the matters at issue on behalf of the I.R.S., and affirmatively fostering the belief that he possessed the requisite authority.

The I.R.S. argues that the debtor was aware of Mr. Wong's lack of authority. However, the evidence shows only that he advised the debtor that obtaining a stipulated order which would have res judicata effect would involve time-consuming red

tape. He never, however, indicated that he did not have the authority to otherwise bind the I.R.S. in the settlement negotiations. In fact, he attempted to create the impression that he possessed the requisite authority, telling the debtor that she "had a deal" and proposing a procedure for settling the claims which he represented would avoid the necessity of any further review. Mr. Wong prepared the Consent to Assessment form in Mr. McGinnis's case, which stated the parties agreement that postpetition interest would be allowed only to the extent provided in the Chapter 11 plan, and signed a notation on that document in which he acknowledged and agreed to those conditions. Mr. Wong explained that he added the endorsement "to provide Mr. McGinnis some assurance that this is what we were going to do." Tr. at 156. In other words, he signed the agreement to foster the impression that he had bound the I.R.S. to an agreement waiving postpetition interest except as provided in the plan. As discussed more fully above, the scope of the McGinnis and Price settlements were the same, and Mr. Wong wrote a confirming letter assuring the debtor that they had a deal which included postpetition interest. See Ex. 1.

The I.R.S. next contends that Mr. Wong's authority was grounded in federal statutes, and therefore the plaintiff is deemed to have been on notice of his lack of authority. However, the delegation of settlement authority is governed by an internal

I.R.S. procedure known as the "Houston Plan." That plan is not published nor available to the general public, Tr. at 176, 177, and the debtor cannot be deemed to have constructive notice of its contents.

The I.R.S. argues that the debtor did not rely on Mr. Wong's conduct. That is incorrect. The debtor, in reliance on the agreement, structured her plan around the agreement, borrowed money in reliance on the agreement, incurred attorney fees in finalizing and consummating the settlement and paid money to the I.R.S. She kept her side of the bargain by paying money and not objecting to the amended proofs of claim filed by the I.R.S. The settlement, having been consummated, cannot be undone. In addition, others have also relied to their detriment on the settlement. Mr. Mastro advanced the money with the belief that no further tax liens could be imposed on the property securing the debtor's obligation to him. The IRS cannot contend that there has been no detriment as a result of reliance on the settlement.

Finally, the I.R.S. contends that there is no evidence of affirmative misconduct. I disagree. Mr. Wong, as an agent of the I.R.S., had an obligation to deal with the debtor fairly and in good faith. If he had any doubts regarding the scope of the settlement or his authority to conclude the matter on behalf of the I.R.S., he should have disclosed those reservations. He did

not do so. Instead, he coaxed the debtor into the settlement agreement by acting as if he possessed the authority to settle the case. He proposed a settlement procedure which he contended was designed to avoid the necessity of further approval by his superiors. Mr. Wong prepared the documentation to implement the settlement procedures. He signed "comfort letters" in the form of an endorsement on the Consent to Assessment and exhibit 1, despite harboring secret doubts about his authority to do so. He listened to the debtors explain their intent to settle all outstanding tax issues, and said nothing. On behalf of the I.R.S., he worked out a settlement in which the debtor withdrew her objections to the I.R.S.'s tax claims, thereby relinquishing her right to a hearing on the disputed taxes. On behalf of the I.R.S., he accepted a settlement check, which was accompanied by a letter reiterating the debtor's understanding that the payment operated to extinguish any liability for postpetition interest. Others within the I.R.S. participated in the settlement discussions, and the I.R.S. accepted the benefits of the settlement.

The above facts present one of those rare situations in which justice and fair play outweigh the policy in favor of an efficient collection of the public revenue. See Schuster v. C.I.R., 312 F.2d 311, 317 (9th Cir. 1962). As stated in Brandt v. Hickel, 427 F.2d at 57 (9th Cir. 1970), "To say to [the misled

citizen], 'The joke is on you. You shouldn't have trusted us,' is hardly worthy of our great government." The debtor is therefore entitled to a judgment declaring that the I.R.S. is barred from collecting or maintaining a lien for postpetition interest on prepetition taxes except to the extent provided in her plan of reorganization.

This Memorandum Opinion shall constitute findings and conclusions as required by Fed. R. Civ. P. 52 and Fed. R. Bankr. P. 7052. They shall not be separately stated. Mr. VanKoten should present an appropriate form of judgment.

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ELIZABETH L. PERRIS
Bankruptcy Judge

cc: Jeffrey Wong
Victor VanKoten